

## SUMMARY ANALYSIS OF AMENDED BILL

Author: Wayne Analyst: Jeff Garnier Bill Number: AB 305

Related Bills: AB 1991, AB 2107  
AB 2131 Telephone: 845-5322 Amended Date: 4-30-98

Attorney: Doug Bramhall

Sponsor:

**SUBJECT:** Health Insurance Deduction/100% of Amount Paid

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended May 8, 1998.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED \_\_\_\_\_ STILL APPLIES.

☒ OTHER - See comments below.

### SUMMARY OF BILL

Under the Personal Income Tax Law (PITL), this bill would change the existing deduction from gross income of 25% of a self-employed individual's cost for health insurance to 100% of the amount paid, limited to the amounts paid on behalf of active state employees for health insurance provided through the Public Employees Retirement System (PERS). The amount of health insurance currently provided through PERS on an annual basis is \$2,088 for the employee, \$3,876 for the employee plus one other family member, and \$4,920 for the employee plus two or more family members.

### SUMMARY OF AMENDMENT

The amendment removed the intent language added by the January 1, 1998, amendment and replaced it with the language contained in the bill prior to the inclusion of the intent language (the May 8, 1997 version). The amendment did not resolve the department's Technical and Implementation Considerations included in the May 8, 1997 analysis.

### EFFECTIVE DATE

This bill would be effective for taxable years beginning on or after January 1, 1998.

DEPARTMENTS THAT MAY BE AFFECTED:

\_\_\_ STATE MANDATE

\_\_\_ GOVERNOR'S APPOINTMENT

Board Position:

\_\_\_ S \_\_\_ O  
\_\_\_ SA \_\_\_ OUA  
\_\_\_ N \_\_\_ NP  
\_\_\_ NA \_\_\_ NAR  
\_\_\_ X \_\_\_ PENDING

Agency Secretary Position:

\_\_\_ S \_\_\_ O  
\_\_\_ SA \_\_\_ OUA  
\_\_\_ N \_\_\_ NP  
\_\_\_ NA \_\_\_ NAR  
DEFER TO \_\_\_\_\_

**GOVERNOR'S OFFICE USE**

Position Approved \_\_\_  
Position Disapproved \_\_\_  
Position Noted \_\_\_

Department/Legislative Director Date  
**Johnnie Lou Rosas** **5/14/98**

Agency Secretary Date

By: Date:

## SPECIFIC FINDINGS

The department's prior analysis of the bill as amended May 8, 1997, still applies. The Technical and Implementation Considerations are restated here.

### Policy Considerations

This bill may improperly delegate Legislative powers to a state agency. The amount PERS pay on behalf of a state employee is subject to the employee's bargaining unit's labor contract. The Legislature does negotiate or ratify labor contracts.

### Technical Considerations

The bill uses the term "health insurance" but does not define it. Health insurance is not defined in the Internal Revenue Code (IRC); however, medical insurance is defined as any insurance for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body. The term "health insurance" is used in the IRC in the title of the subsection allowing medical insurance paid by self-employed individuals as a partial deduction in computing the taxpayer's adjusted gross income. It is not clear if the bill intends to limit the amount to just health insurance or to health, dental, and vision insurance.

The bill does not clarify whether a taxpayer filing a return as a single person with no dependents (for tax purposes or otherwise) would be entitled only to the amount paid on the behalf of a employee, with no dependents. It could be argued that all taxpayers would be allowed the maximum amount paid on behalf of an active state employee.

Additionally, the amendment uses the plural of employee. The bill is not clear whether the aggregate amount deducted by all taxpayers is limited by the aggregate amount of benefits paid on behalf of all state employees. If the aggregate deduction is limited to the aggregate amount paid on behalf of all state employees, the bill does not specify all the aggregate deduction would be allocated to taxpayers if the allowable amount is exceeded.

Amendment 1 attached to this analysis would resolve the department's policy and technical considerations.

### Implementation Considerations

Assuming the "improper delegation of Legislative powers" policy consideration is resolved, the department has the following implementation consideration.

The maximum amount PERS will pay for the health insurance component benefit changes when a new labor contract is signed by the state government and labor unions. The effective date of the change has historically been January 1<sup>st</sup> of the year following the year the labor contract was signed. Presently, state employees are not working under a labor contract; therefore, the health insurance amounts negotiated for the last signed contract remain in effect. The next signed labor contract could make any increase or decrease in health insurance benefits effective during any part of the year, making the implementation of this bill difficult.

## FISCAL IMPACT

### Tax Revenue Estimate

The revenue losses from this provision are estimated to be as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 1997 Enactment Assumed After June 30, 1998 \$ Millions			
1998-9	1999-0	2000-01	2001-02
(\$42)	(\$36)	(\$41)	(\$48)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

### Revenue Discussion

The revenue impact of this provision would be determined by the number of self-employed individuals who claim additional insurance deductions and the average marginal tax rate applicable to the deduction amounts.

This amended version is identical to the amendment version dated May 8, 1997 with the exception of the effective date change from 1997 to 1998. For this estimate, the growth rate on health insurance premiums from 6.5% to 7%, based on current data.

This estimate was developed in the following steps. First, the number of California resident taxpayers who currently claim the self-employed insurance deduction was calculated from returns filed for 1995 (425,000). Second, the current deduction amount of 25% was calculated to be \$839 on average for returns filed in 1995, making the average annual health insurance premium \$3,356 (\$839 x 4). Third, the estimated number of qualified taxpayers for 1995 was grown at 5% per year to yield 492,000 qualified taxpayers for 1998. Fourth, the insurance premium was grown at 7% per year to yield an average \$4,111 insurance premium for 1998. Fifth, the total deduction at 25% was calculated to be \$506 million for 1998, and the additional amount deducted for health insurance premiums on Schedule-A was \$388 million, generating a total deduction amount under current law of \$894 million. At an average marginal tax rate of 4.5% (computed by the PIT microsimulation model for self-employed individuals), the current law revenue loss for 1998 is \$40 million. Sixth, the qualified taxpayers were separated by filing status and number of dependents, in order to apply the amount of health care premiums paid by the state through PERS (for 1998 these amounts are \$2,088 for one individual, \$3,876 for two and \$4,920 for two or more). Seventh, the total deductions under the proposal was calculated at 100% at a 4.5% marginal tax rate, generating a \$69 million tax loss for 1998. These steps resulted in a 1998 estimate of an additional \$29 million tax loss. The 1998-9 fiscal year estimate consists of the 1998 tax loss (\$29 million) and 40% of 1999 reflecting reduced estimated tax payments.

### BOARD POSITION

Pending.

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Attorney          Doug Bramhall

FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 305  
As Amended April 30, 1998

AMENDMENT 1

On page 2, beginning with line 17, make Section 17273 read as follows:

17273. ~~(a) Section 162(1)(1) of the Internal Revenue Code, relating to applicable percentage, special rules for health insurance costs of self-employed individuals is modified by substituting "100 percent" for the percentages specified in that section as follows:~~

(a) In Section 162(1)(1) of the Internal Revenue Code substitute "100 percent" in lieu of the percentages specified in that section.

(b) For taxable years beginning on or after January 1, 1997, Section 162(1)(2) is modified so that the maximum amount of the deduction allowed by this section shall not exceed the amount paid on behalf of active state employees for health insurance provided through the Public Employees Retirement System. The amount of the deduction allowed for the taxable year under this section to a self-employed individual shall not exceed \$2,088 for taxpayers filing with one personal exemption as determined under Section 17054(a), (b) and (d), \$3,876 for taxpayers filing with two personal exemption as determined under Section 17054(a), (b) and (d), and \$4,920 for taxpayers filing with three or more personal exemption as determined under Section 17054(a), (b) and (d).